U. S. Senate
Republican Policy
Committee

Larry E. Craig, Chairman   Jade West, Staff Director

Legislative Notice

No. 3   March 2, 2001

S. 420 - The Bankruptcy Reform Act of 2001

There is no written committee report. S. 420 is an original bill reported from the Committee on the Judiciary by a vote of 10 to 8 and placed on the Senate Calendar on March 1, 2001 (No. 16).

NOTEWORTHY

- The Senate will proceed to S. 420 on Monday, March 5, 2001, at 2:00 p.m.

- S. 420 is based on the Bankruptcy Reform Conference Report that Congress passed overwhelmingly last year, but it has amendments adopted by the Judiciary Committee during markup. President Clinton (pocket) vetoed the conference report last year.

- The House passed its bankruptcy bill, as amended, on March 1, 2001, by a vote of 306 to 108. The House bill (H.R. 333) also is based on last year's conference report.

- The Senate approved last year's reform act (the Conference Report to H.R. 2415) on December 7, 2000, by a vote of 70 to 28 (after invoking cloture two days earlier). Fifty-three GOP Senators voted for the conference report, as did 17 Democratic Senators. The House had approved the conference report on October 12, 2000, by voice vote. The 106th Congress adjourned *sine die* without a vote on overriding the President's veto.

- When the Senate first passed its bankruptcy reform bill in the 106th Congress on February 2, 2000, the bill included several nongermane amendments, including minimum wage, tax reform, health insurance, and drug enforcement amendments. That bill (S. 625 / H.R. 833) passed by a vote of 83 to 14.

- According to the U.S. Department of Justice, creditors lose $3.22 billion every year because of bankruptcies filed by persons *who could repay their debts.* S. Rept. 106-49 at 2. Those costs are then passed along to all Americans. Based on research by the Congressional Budget Office, Senator Grassley has shown that bankruptcies cost each American household about $400 annually in higher costs for goods, services, and credit.

- The Bush Administration favors the kinds of reforms found in S. 420.

BACKGROUND

Legal Authority. The Constitution gives Congress express power "To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." Art. I, §8, cl. 4. Bankruptcy laws have been a permanent part of the federal code for 100 years. The bankruptcy code was overhauled in 1978, and that 1978 act (as amended) governs all bankruptcy cases filed today. See 11 U.S.C. §101 *et seq*.

The Explosion in Bankruptcy Filings. The reform effort is motivated in large part by an explosion in consumer bankruptcies, which is especially troubling because the economy has been healthy. Some of the relevant data are shown in Table 1, which shows that nonbusiness filings have quadrupled since the early 1980s. Proponents of the bill generally point to the long- term trends that are shown in the table, while opponents point to recent data showing a downturn in the numbers in 1999 and 2000.

Table 1. Bankruptcy Petitions Filed
(Selected Years Ending June 30)

	Total	Business	Nonbusiness	Change in Nonbusiness
1981	360,329	47,415	312,914	
1985	364,536	66,651	297,885	- 4.8 %
1990	725,484	64.688	660,796	+ 121.8 %
1995	858,104	51,288	806,816	+ 22.1 %
2000	1,276,922	36,910	1,240,012	+ 53.7 %

[Sources: *Statistical Abstract of the United States, 1999*, Table No. 888, and Administrative Office of the U.S. Courts (Table F2 of the director's annual report). 1981 was used rather than 1980 because 1980 was a transition year between reporting under the old Act and the new. Filings peaked in 1998.]

Why the Explosion? The Senate Judiciary Committee of the 106th Congress said that the bankruptcy code itself is partly responsible for the explosion in personal bankruptcies. The Committee held "the strong view" that "the bankruptcy code's generous, no-questions-asked policy of providing complete debt forgiveness under chapter 7 without serious considerations of a bankrupt's ability to repay is deeply flawed and encourages a lack of personal responsibility." [S. Rept. 106-49 at 3.]

Opponents of the bill, on the other hand, tend to believe that the enormous increase in bankruptcies has less to do with the law or a lack of personal responsibility than with aggressive marketing by credit card companies and others who offer credit too freely. These observers point out that the increases in personal bankruptcy filings have been accompanied by increases in household debt-to-income ratios.

Needs-Based Bankruptcy ("Means-Testing"). "Means-testing" is one of the key concepts in the reforms proposed in S. 420. The bill proposes to use a test to distinguish between those debtors who can repay a portion of their debts and those who can't, and then to require those who can to do so.

Under current law, individuals entering bankruptcy generally proceed under Chapter 7 or Chapter 13, but about 70 percent of bankruptcy filings are under Chapter 7. In **Chapter 7**, the debtor surrenders those assets which do not qualify for an exemption under the law, and the assets are sold to satisfy (in part) the claims of the creditors. Any debt that remains after the sale of the assets is erased (the law calls it "discharged"). Chapter 7 proceedings are what most people have in mind when they speak of *bankruptcy*.

Chapter 13, on the other hand, provides for the creation of a repayment plan to repay a portion of the debtor's debts using future earnings. Under Chapter 13, creditors look to the future earnings of the debtor rather than to the property he currently owns. When the debtor has made his payments as required under the repayment plan, any unpaid portion of his debt is discharged.

The 1984 Amendment. Prior to 1984, an individual contemplating bankruptcy could freely choose between Chapter 7 and Chapter 13. However, as more and more debtors *who had the means to repay some of their debts* chose Chapter 7, Congress amended the bankruptcy code to steer debtors who had sufficient means toward Chapter 13 and repayment. "The focus of the effort was to require bankrupts who had the ability to pay a significant percentage of their debts 'without difficulty' to proceed under Chapter 13 instead of Chapter 7." [S. Rept. 106-49 at 6.] However, the 1984 amendment used a vague term and a difficult test, and Congressional intent eventually was frustrated.

The 1984 amendment added a new part to the bankruptcy code (**section 707(b)**) allowing a Chapter 7 case to be dismissed (thereby steering the debtor to Chapter 13) if the court found there had been "substantial abuse" of the law. However, only a judge or the United States bankruptcy trustee, not a creditor or other party in interest, could make a motion alleging "substantial abuse." Additionally, the prevailing interpretation of section 707(b) came to be that a debtor's filing for Chapter 7 relief even while having an ability to pay his debts was not enough, standing alone, to constitute "substantial abuse." Therefore, section 707(b) has failed to have the hoped-for effect of reducing abuse of the system, and S. 420 addresses the issue again.

Means-Test Under the Pending Bill. S. 420 employs a new means-test (summarized under "Bill Provisions" below) that is designed to require those who can repay their debts to do so, rather than walking away from their obligations and shifting the costs to others, including those "others" who are less wealthy than the debtor. When the conference report was being considered in the House last year, Representative George W. Gekas (R, PA-17) said:

> "[W]e cannot permit people to use the bankruptcy system as a mechanism for financial planning. If we take an objective look at someone's resources and their earning power, and if we determine through the bankruptcy system that there is an ability on the part of

this individual to repay some of his debt, albeit not all of it, and not immediately, but over a period of years, then we should compel that individual, through a sympathetic system of transferring that obligation from Chapter 7 to Chapter 13, to work his way out of that debt. We do not demand that he pay every penny back, but that he return some of the money. It is unfair for such an individual, who could repay, to be absolved of any obligation and then lay his burden at the doorstep of every other consumer and taxpayer in the country." 146 Cong. Rec. H9832 (daily ed. Oct. 12, 2000) (edited).

Background on the *Time* Magazine Story. Readers may be aware that *Time* Magazine published a "special investigation" of an earlier version of the bankruptcy reform act in its edition of May 15, 2000. The subheading for the article read, "Lavished with campaign cash, lawmakers are 'reforming' bankruptcy [by] punishing the downtrodden to catch a few cheats." Senator Grassley says that the *Time* article "is simply false" [146 Cong. Rec. S11661 (daily ed. Dec. 6, 2000)], and Senator Biden says the article "is simply dead, flat, absolutely wrong" [146 Cong. Rec. S5385 (daily ed. June 20, 2000)]. Contrary to the *Time* story, *all* of the families it profiled still would be eligible for "straight bankruptcy" under Chapter 7 because their household income is below the median income for the State in which they reside. The "means-test" simply would not apply to these families.

Additionally, as Senator Biden points out, even if a family were required to use Chapter 13 rather than Chapter 7, it doesn't mean that the family is denied bankruptcy protection, but that the family has been steered into a different bankruptcy plan because the family has some capacity to repay some of its debts. "Chapter 13 was added to the bankruptcy code in the 1930s as the more desirable alternative to the draconian liquidation required under Chapter 7," said Senator Biden. "It was conceived as the 'wage earner's' form of bankruptcy for those who had an income and the ability to pay some of their creditors but who needed protection of the system to keep their creditors from hounding them." *Id*.

Background on the Schumer "Abortion Clinic Amendment." Last Congress, the Senate adopted a Schumer amendment that would make nondischargeable in bankruptcy any debt that resulted from a judgment for damage to an abortion clinic or other health care clinic or for violating the civil rights of an individual who provides or obtains an abortion or other health care services. That amendment was dropped in conference, at least in part because the amendment was thought to be unnecessary. Senator Grassley asked the Congressional Research Service (CRS) to survey the relevant cases, and the CRS reply memorandum read in part:

"The only reported decision identified by the [requested computer] search is *Buffalo Gyn Womenservices, Inc. v. Behn* (*In re Behn*). In this case, the bankruptcy court held that a debtor's previously incurred civil sanctions for violation of a temporary restraining order (TRO) creating a buffer zone outside the premises of an abortion service provider [were] nondischargeable under 11 U.S.C. §523(a)(6), which excepts claims for 'willful and malicious' injury. . . . Specifically, the court held: '[W]hen a court of the United States issue[s] an injunction or other protective order telling a specific individual what actions will cross the line into injury to others, then damages resulting from an intentional violation of that order . . . are *ipso facto* the result of a "willful and malicious injury."'" CRS Memorandum at 146 Cong. Rec. S 11414 (daily ed. Oct. 31, 2000) (case citations omitted). See also, 146 Cong. Rec. S 11553 (daily ed. Dec. 5, 2000) (remarks of Sen. Biden) (Schumer amendment "is not necessary to protect the very people we want to protect").

The Schumer-Hatch Amendment. This year on February 28, 2001, the Judiciary Committee adopted an amendment sponsored by Senators Schumer and Hatch that makes nondischargeable in bankruptcy any debt that arises from a person's "harassment of, intimidation of, interference with, obstruction of, injury to, threat to, or violence against" any other person who is providing or obtaining legal goods or services. The amendment was accepted without recorded vote.

BILL PROVISIONS

Both the Senate and the House bills of this year are based on last year's conference report. Therefore, a description of that conference report is helpful in understanding this year's bills, although both the Senate and House bills have been amended since introduced (at introduction, both bills were essentially identical to the conference report).

There is no committee report on S. 420. However, the House Judiciary Committee filed a report, H. Rept. 107-3, 107th Cong., 1st Sess., and that report is a reliable source on the underlying provisions. A section-by-section summary of last year's conference report may be found at: http://www.congress.gov/cgi-lis/bdquery/z?d106:SN03186:@@@D&summ2=m&.
A helpful short summary of this year's bills-as-introduced is CRS Report No. RL 30865, "Bankruptcy Reform Legislation in the 107th Congress: H.R. 333 and S. 220," (Feb. 26, 2001).

Some of the key reforms in S. 420 are summarized here:

Means-test. The bill employs a "means-test" to steer filers who can repay a portion of their debts away from Chapter 7. That means-test employs a legal presumption that Chapter 7 proceedings should be dismissed or converted into Chapter 13 proceedings whenever the filer earns more than the median income *and* can repay (the lesser of) $10,000 or 25 percent (but not to be less than $6,000) of his unsecured debt over five years. A debtor may rebut the presumption by demonstrating "special" circumstances.

In calculating the debtor's income, living expenses are deducted as permitted under I.R.S. standards, and the bill also permits deductions for expenses to protect the family from domestic violence; actual expenses for the care and support of elderly or ill nondependent family members (Senator Leahy successfully amended the bill in committee to expand this provision to disabled or chronically ill children or grandchildren who are not dependents); private school tuition of up to $1,500 per year; and other expenses.

Debtors who earn less than the median income are provided with a "safe harbor" that prevents creditors from bringing a motion to dismiss or convert their Chapter 7 proceedings.

Homestead exemption. The bill imposes longer residency requirements before a debtor can take advantage of a state's homestead exemptions. The bill extends to seven years the period for which the value of assets converted to an otherwise exempt homestead must be subtracted from the value of the homestead exemption if the conversion was made to hinder, delay, or defraud a creditor. Debtors electing a state homestead exemption may not exempt any interest that was acquired within two years of the bankruptcy filing if the interest exceeds $100,000, unless the excess value results from a transfer of residences within the state. Family farmers are exempt from the limit, however. Hence, the state opt-out program for bankruptcy exemptions remains intact, but debtors will find bars or barriers to some abusive transactions.

Domestic support obligations. The bill makes domestic support obligations the first priority of unsecured claims under 11 U.S.C. §507. The bankruptcy trustee must notify a recipient of child support payments of the existence of a state child-support enforcement agency, and, upon discharge, of the fact that the child support obligation is nondischargeable. To allow governments to collect domestic support payments, the bill makes various exceptions to the bankruptcy code's automatic stay provisions (which otherwise might bar collections). Other, similar reforms also are in the bill.

Consumer protections. The bill amends the Truth in Lending Act to require certain credit card solicitations, monthly billing statements, and related documents to include disclosures and explanations on interest rates, minimum payments, and other matters. Lenders would be required to provide a toll-free number that credit card users could call to find out how many months it would take to pay off a loan if only minimum payments are made. There are reforms that allow debtors to understand their rights and obligations with respect to reaffirming their debts, and the bill requires that one assistant U.S. attorney in each judicial district and one FBI agent in each field office be designated as having primary responsibility for investigating and prosecuting abusive reaffirmation practices. Consumers are required to participate in credit counseling programs before filing for bankruptcy. The counseling is designed to help them understand the consequences of declaring bankruptcy, and to offer assistance in getting out of their financial difficulties. There are also reforms that will help ensure that those who assist consumers in the bankruptcy system are qualified to do so.

Family farms. The conference report makes Chapter 12 of the bankruptcy code permanent. This is the chapter that governs reorganization of family farms, and it expired on July 1, 2000. In Committee, Senator Feingold added an amendment that raises from $1.5 million to $3.0 million the debt limit for using Chapter 12, and cuts from 80 percent to 50 percent the amount of income in the prior year that would have had to come from farming. The second amendment helps ensure that farmers completing Chapter 12 have enough income to prepare for the coming year's crops and livestock.

Health care providers. The bill helps protect the quality of patient care, especially for nursing home residents, if the provider declares bankruptcy. Also, the bill protects the privacy of medical records when the records are in the custody of a health care business in bankruptcy.

Pensions. The conference report clarifies and expands the law to provide that retirement accounts that are tax exempt under the Internal Revenue Code are exempted from the debtor's estate, subject to a $1,000,000 cap.

Privacy. A Leahy-Hatch amendment adopted by the Committee protects consumer privacy in bankruptcy cases by barring, under certain circumstances, customer lists from being sold as part of business assets. The amendment also provides for the appointment of a consumer privacy ombudsman in some bankruptcy cases.

Judgeships. The underlying bill provides for new, temporary bankruptcy judgeships for some districts, and a Leahy amendment accepted by the Committee added or extended others.

Readers are encouraged to refer to the bill language itself for details on these provisions and others. Some of the provisions are complicated and a short description may miss many points.

ADMINISTRATION POSITION

On February 28, 2001, the Bush Administration issued the following official Statement of Administration Policy on the House bill, H.R. 333, as reported:

> "The Administration supports the overall package of bankruptcy reforms reflected in H.R. 333. These commonsense reforms will curb many of the abuses of the current bankruptcy protections. In addition, the Administration supports the bipartisan compromise language that was adopted by the last Congress regarding the homestead exemption."

COST

No official cost estimate is available for S. 420. However, in the Judiciary Committee's report from last Congress, CBO estimated that implementing the Committee-reported bill, S. 625, would cost $218 million over the 2000-2004 period — $207 million in discretionary spending (i.e., subject to appropriation of the necessary funds) and $11 million in mandatory spending. CBO also estimated that enacting the bill would have increased receipts by about $2 million over the same period. [S. Rept. 106-49 at 66.] The bill has, of course, been changed since that estimate was made, and the increase in the number of bankruptcy judgeships will increase the costs. Other changes also may affect the costs.

OTHER VIEWS

There is no committee report on S. 420, but the 1999 report from the Senate Judiciary Committee on S. 625, S. Rept. 106-49, contains much helpful information from both supporters and opponents. Keep in mind that, since that report was written, the bankruptcy bill has been amended on the Senate floor, in a conference committee, and back again in the Judiciary Committee. The House report of this Congress, H. Rept. No. 107-3, also contains majority and minority views.

The American Bankers Association's "Summary of Key Provisions of the Bankruptcy Reform Conference Report" (dated October 18, 2000) is helpful and may be found at http://www.aba.com/Industry+Issues/GR_BR_confreport.htm. The bankers support the bill.

Opponents of the conference report listed some of their objections to the child support provisions in a letter that was published at 146 Cong. Rec. H 9838 (daily ed. Oct. 12, 2000). The position of the former Administration (President Clinton (pocket) vetoed the bill), is shown in a letter from John Podesta, former White House Chief of Staff, to the Honorable Dennis Hastert, Speaker of the House, 146 Cong. Rec. H 9836 (daily ed. Oc. 12, 2000).

POSSIBLE AMENDMENTS

No authoritative list of amendments is available. However, germane and nongermane amendments can be anticipated. Some members of the Judiciary Committee did say that they had germane amendments that they would bring to the floor, and these included amendments on means-testing, the homestead exemption, credit card solicitations, and other matters. Senators Wellstone and Feingold have promised several amendments. Amendments will not be called up until Tuesday, March 6, 2001.

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